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EXEMPT REPORTING ADVISERS: REQUIREMENTS FOR INVESTMENT ADVISERS THAT QUALIFY AS VENTURE CAPITAL ADVISERS OR PRIVATE FUND ADVISERS

The Dodd-Frank Act changed the U.S. Investment Advisers Act of 1940 (the "Advisers Act") in a way that requires many more investment advisers to register with the U.S. Securities and Exchange Commission. The Dodd-Frank Act changes also created a new class of investment advisers that are generally referred to as "Exempt Reporting Advisers" ("ERAs"). ERAs are advisers that rely on either of the Venture Capital Fund Adviser Exemption or the Private Fund Adviser Exemption.[1] The changes will also require some advisers that are currently registered to deregister with the SEC and instead register with a state.

HOW DOES AN INVESTMENT ADVISER DETERMINE IF IT NEEDS TO REGISTER AT THE FEDERAL OR STATE LEVEL?

Those investment advisers that are not otherwise exempt and that have assets under management of:

- between $0 and $25 million ("Small Advisers") must register with the relevant state regulatory authority (they are not permitted to register with the SEC).
- between $25 million and $100 million ("Mid-Sized Advisers") must register with the relevant state regulatory authority[2] (they are not permitted to register with the SEC).[3]
- more than $100 million ("Large Advisers") must register with the SEC (they cannot register with the states).

HOW IS EXEMPT REPORTING ADVISER STATUS RELEVANT TO LARGE ADVISERS?

A Large Adviser that qualifies as either a Venture Capital Fund Adviser or Private Fund Adviser can elect to be treated as an ERA. An ERA will not be required to register with the SEC but will be subject to certain reporting, recordkeeping, and other obligations.

HOW IS EXEMPT REPORTING ADVISER STATUS RELEVANT TO MID-SIZED ADVISERS?

As a general rule, Mid-Sized Advisers do not register with the SEC but, rather, are subject to state registration. However, if a Mid-Sized Adviser is exempt from investment adviser registration under the law of the state in which it has its principal office and place of business, or is excluded from the definition of "investment adviser" in that state, then unless the adviser can avail itself of an exemption under the Advisers Act, it will have to register with the SEC. That is where ERA status becomes relevant for Mid-Sized Advisers. A Mid-Sized Adviser that is exempted from registration in the state in which it has its principal office and place of business, and therefore is required to register with the SEC, can nonetheless use its ERA status to avoid registration under the Advisers Act.

WHAT MUST ERAs FILE WITH THE SEC?

ERAs must complete the following items on Part 1 of the Form ADV: [4]

- Item 1 – Identifying Information (*e.g.*, ownership, description of advisory business, and fees charged);
- Item 2. B and C – SEC and State Reporting by Exempt Reporting Advisers;
- Item 3 – Form of Organization;
- Item 6 – Other Business Activities;
- Item 7 – Financial Industry Affiliations and Private Fund Reporting;
- Item 10 – Control Persons;
- Item 11 – Disclosure Information (*e.g.*, disciplinary history); and
- Schedules A, B, C, and D with respect to any corresponding answers to the above items.

The Form ADV-NR is the mechanism by which an ERA appoints the Secretary of the SEC as an agent for service of process. Every nonresident general partner and managing agent of an ERA, whether or not the adviser is resident in the United States, must file Form ADV-NR along with the adviser's initial ADV Part 1. The Form ADV-NR must be filed on paper (it cannot be filed electronically).[5]

HOW IS THE FORM ADV PART 1 FILED?

ERAs are able to complete the necessary items of the Form ADV Part 1 online through the Investment Adviser Registration Depository (the "IARD") at www.iard.com. Advisers must apply for access to the IARD system by submitting entitlement forms to the IARD.[6] Please note, ERAs must request access to the IARD system by completing the IARD Entitlement Package. Processing of the Entitlement Package can take approximately three business days. It is important that this process is completed *before* filing.

WHEN MUST THE FORM ADV PART 1 BE FILED?

An ERA must file its Form ADV Part 1 on or before March 30, 2012. Going forward (*i.e.*, after the March 30, 2012 deadline), new ERAs must file within 60 days of becoming an ERA.

ARE THERE OTHER FILINGS AND REPORTS REQUIRED?

When an ERA files with the SEC or amends its filing, some state securities authorities will require additional filings, fees, and additional reporting.[7] These additional filings may include a "notice filing" that will send the ADV electronically to states selected by the ERA on Item 2.C. of Part 1A. It is important to make an assessment under each individual state law as to whether an ERA is subject to notice filing requirements in individual states.

WILL THE INFORMATION FILED WITH THE SEC BE PUBLICLY AVAILABLE?

All of the information filed by ERAs on Form ADV will be available to the public through the IARD.

WHO CAN SIGN THE FORM ADV?

If the ERA is:

- a sole proprietor, the owner must sign the Form individually.
- a partnership, a general partner must sign the Form in the name of the partnership.
- an unincorporated organization or association that is not a partnership, the managing agent must sign the Form in the name of the organization or association.
- a corporation, a principal officer duly authorized must sign the Form in the name of the corporation.

If an officer of any entity is signing the Form, the officer's title must be given.

ARE THERE ONGOING REQUIREMENTS?

- **Updates to Form ADV Part 1.** An ERA will be required to update its Form ADV Part 1, which will require updating all Form ADV responses previously submitted, at least annually within 90 days of the end of the adviser's fiscal year, and more frequently for material developments as required by the instructions to Form ADV.[8]
- **Recordkeeping Requirements.** Section 204 of the Advisers Act requires investment advisers to make and keep such records and to make and disseminate such reports as the SEC may prescribe by rule. The Advisers Act has an express exemption from this requirement for certain exempt advisers (such as foreign private advisers) but not for ERAs. Accordingly, ERAs could be subject to SEC recordkeeping requirements, and the SEC will have the authority to examine such records. Specific recordkeeping obligations, which could significantly increase ERAs' compliance costs, have not been established but could be the subject of future SEC rulemaking.
- **Policies Regarding Material Nonpublic Information ("MNPI").** Section 204A of the Advisers Act includes a general requirement that all advisers subject to Section 204 (which includes ERAs) "establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such investment adviser's business, to prevent the misuse in violation of [the Advisers] Act or the Securities Exchange Act of 1934, or the rules or regulations thereunder, of material, nonpublic information by such investment adviser or any person associated with such investment adviser." ERAs should consider the nature of their business and establish appropriate written policies designed to prevent the misuse of MNPI.
- **Other Requirements.** In addition to compliance requirements that apply to advisers regardless of their registration status (*e.g.*, the Advisers Act's anti-fraud provisions), ERAs must comply with the Advisers Act's "pay to play" rule.[9] The SEC expects to conduct "for cause" examinations of ERAs when it believes there have been indications of wrongdoing (*e.g.*, examinations prompted by tips, complaints, and referrals) but does not anticipate that it will conduct routine examinations of ERAs, although it has the authority to do so.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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ENDNOTES

1 Generally, ERAs are investment advisers that rely on either the Venture Capital Fund Adviser Exemption (Advisers Act Section 203(l)) or the Private Fund Adviser Exemption (Advisers Act Section 203(m)). These new exemptions were adopted under the Dodd-Frank Act. *See*, www.sec.gov/rules/final/2011/ia-3222.pdf. The Venture Capital Fund Adviser Exemption is generally available to investment advisers that solely advise venture capital funds. The Private Fund Adviser Exemption is generally available to advisers that only manage private funds and have less than $150 million in assets under management. For non-U.S. advisers, the Private Fund Adviser Exemption requires only that the U.S. clients of the adviser be private funds and that only assets managed from the U.S. are counted toward the $150 million cap.

2 *See* Section 203A of the Advisers Act, and Rule 203A-1 thereunder. More information is available from: www.sec.gov/divisions/investment/midsizedadviserinfo.htm. Some states are adopting or proposing for adoption new exemptions for Mid-Sized Advisers that are similar to exemptions for ERAs. For example, *see*: Connecticut: www.ct.gov/dob/cwp/view.asp?a=2252&q=482932; California: www.corp.ca.gov/Laws/CSL/BDIA/Default.asp. Also, the North American Securities Administrators Association ("NASAA") has adopted a model rule that includes certain exemptions from registration for certain advisers to private funds: www.nasaa.org/wp-content/uploads/2012/01/NASAA-Registration-Exemption-for-Investment-Adviser-to-Private-Funds-Model-Rule.pdf.

3 Investment advisers with more than $25 million in assets under management whose principal offices are in New York or Wyoming are required to register with the SEC, notwithstanding the fact that their assets under management are less than $100 million (unless they also meet the requirements of a federal exemption).

4 The entire Form and Instructions can be obtained at: www.sec.gov/about/forms/formadv-instructions.pdf. A copy of the Form ADV Part 1 marked to show the items to be completed by an ERA is available here.

5 Submit Form ADV-NR to the SEC at the following address: Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549; Attn: Branch of Registrations and Examinations. A general partner or managing agent of an ERA who becomes a nonresident after the adviser's initial ADV Part 1 has been submitted must file Form ADV-NR within 30 days.

6 A copy of the IARD Entitlement Package can be obtained at www.iard.com/GetStarted.asp. An ERA can request access to the IARD system by completing and submitting the IARD Entitlement Package on paper with original signatures to: FINRA Entitlement Group, P.O. Box 9495, Gaithersburg, MD 20898-9495.

When FINRA receives the Entitlement Package, it will assign a CRD number (*i.e.*, an identification number for the investment adviser) and a user I.D. code and password (*i.e.*, an identification number and system password for the individual(s) who will submit Form ADV filings for the adviser). Investment advisers may request an I.D. code and password for more than one individual. FINRA also will create a financial account for the investment adviser from which the IARD will deduct filing fees and any state fees the adviser is required to pay. The current initial SEC filing fee for an ERA is $150.

7 NASAA provides information about state investment adviser laws and state rules, and how to contact a state securities authority, on its web site: www.nasaa.org. NASAA has proposed a model rule for states to consider adopting for Exempt Reporting Advisers: www.nasaa.org/wp-content/uploads/2012/01/NASAA-Registration-Exemption-for-Investment-Adviser-to-Private-Funds-Model-Rule.pdf.

8 Other than annual amendments are required if (1) information previously provided to Items 1, 3, or 11 of the Form ADV becomes inaccurate or (2) information previously provided in Item 10 of the Form ADV becomes materially inaccurate.

9 Advisers Act, Rule 206(4)-5.